

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>SRS NEWS, INC.</b>	:	DETERMINATION
	:	DTA NO. 817006
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period June 1, 1994 through August 31, 1998.	:	

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Petitioner, SRS News, Inc., 906 Second Avenue, New York, New York 10017, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1994 through August 31, 1998.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on November 9, 1999 at 10:30 A.M., and continued to its conclusion on June 6, 2000 at 10:30 A.M., with all briefs submitted by December 14, 2000, which date began the six-month period for the issuance of this determination. Petitioner appeared by Mukesh Desai, CPA. The Division of Taxation appeared by Barbara G. Billett, Esq. (Robert A. Maslyn, Esq., of counsel).

***ISSUES***

I. Whether, as a result of an audit, the Division of Taxation properly determined additional sales tax due.

II. Whether petitioner established that it had reasonable cause for abatement of penalty and reduction of interest.

***FINDINGS OF FACT***

1. Petitioner's principal business activity was a retail convenience store located at 906 Second Avenue in Manhattan, near 48<sup>th</sup> Street, known as SRS News, Inc. Its principal products included newspapers, magazines, cigarettes, candy, soda, and paperback books. Occasionally there were sales of greeting cards, disposable razors, condoms, and batteries. Petitioner was incorporated on April 22, 1993 in New York State, and elected to report its business operations as an S corporation commencing January 1, 1994. Petitioner's president and sole shareholder was Sureshkumar B. Brahmbhatt. Susan Brahmbhatt, Sureshkumar's wife, was responsible for the day-to-day operations of the store.

2. Petitioner was registered as a vendor for sales tax purposes and filed New York sales tax returns for the audit period, June 1, 1994 through August 31, 1998. Petitioner reported as gross and taxable sales the following amounts for the audit period:

Period Covered by Return	Gross Sales Reported	Taxable Sales Reported
June 1, 1994-August 31, 1994	\$25,879.00	\$5,176.00
September 1, 1994-November 30, 1994	25,204.00	5,041.00
December 1, 1994-February 28, 1995	25,347.00	5,069.00
March 1, 1995-May 31, 1995	25,302.00	5,060.00
June 1, 1995-August 31, 1995	25,912.00	5,182.00
September 1, 1995-November 30, 1995	46,126.00	32,926.00
December 1, 1995-February 28, 1996	42,215.00	28,560.00
March 1, 1996-May 31, 1996	43,324.00	29,424.00
June 1, 1996-August 31, 1996	43,109.00	28,363.00
September 1, 1996-November 30, 1996	42,618.00	28,197.00
December 1, 1996-February 28, 1997	42,578.00	23,178.00

March 1, 1997-May 31, 1997	\$43,976.00	\$24,186.00
June 1, 1997-August 31, 1997	42,722.00	24,102.00
September 1, 1997-November 30, 1997	**	24,845.00
December 1, 1997-February 28, 1998	**	23,871.00
March 1, 1998-May 31, 1998	**	24,669.00
June 1, 1998-August 31, 1998	**	25,705.00

\*\* These amounts no longer appear on the sales tax returns.

3. Prior to the commencement of an audit by the Division of Taxation (“Division”), a survey of petitioner’s business premises was conducted by one of the Division’s investigators. The investigator either observed or was informed that petitioner was open seven days a week, with hours Monday through Saturday from 7:00 A.M. to 10:00 P.M., and Sundays from 7:00 A.M. to 7:00 P.M. Petitioner operated with one cash register and two employees. He observed that petitioner was a small convenience store selling magazines, newspapers, paperback books, candy, cigarettes, soda and some greeting cards. It was noted by the investigator that the store did not sell any beer and had no liquor license. No further information concerning the products sold was noted by the investigator.

4. The Division commenced a sales tax audit of petitioner’s business, and on April 7, 1997, an appointment letter was sent to petitioner from the Division’s auditor, Steven Levine, which defined the original audit period as June 1, 1994 through February 28, 1997, and requested the following books and records from petitioner: journals, ledgers, sales invoices, purchase invoices, cash register tapes, Federal income tax returns and exemption certificates.

5. On May 21, 1997, the Division’s auditor had a meeting with petitioner’s representative, Mukesh Desai, CPA. Mr. Desai informed the auditor that there were no cash disbursements journal and no cash register tapes for petitioner’s business. At that time, he provided Mr. Levine

with a few Borough Hall-Oxford Tobacco Corp. ("Borough Hall") invoices representing purchases made by petitioner and sold in petitioner's business. Borough Hall's letterhead indicated it was a wholesale distributor of cigarettes, matches, cigars, tobacco, candy and paper goods. Petitioner primarily purchased cigarettes, candy and, on occasion, soda from Borough Hall. During that meeting, Mr. Levine reviewed all records provided by petitioner's representative and determined there was no general ledger, cash receipts journal, or purchase invoices sufficient to form a test period for audit purposes.

6. After the audit had commenced, petitioner provided the Division with a breakdown of sales and calculated profitability for the original audit period as follows: of total sales in the amount of \$387,614.00, taxable cigarette sales were \$181,365.00 or 46.8% of the total; taxable sales of all other sundry items were \$14,811.00 or 3.8% of the total; and nontaxable sales were \$191,438.00 or 51% of the total. The chart represented the profitability factor for each category as 17%, 67% and 51%, respectively, with an overall profitability factor, taking into consideration the weighted breakdown of sales, of 36%.

7. As a result of petitioner's failure to produce cash register tapes, sales invoices, daily sales records, purchase invoices for soda, maps, cards and other items, bank statements and cash disbursements journals, the Division's auditor determined that there were insufficient records to perform a detailed audit. The Division next obtained directly from Borough Hall-Oxford Tobacco Corp. a record of purchases from June 1994 through February 1997 made by SRS News

which totaled \$161,445.00.<sup>1</sup> The Division utilized this third-party information to determine petitioner's sales for the audit period.

8. In September 1997, petitioner provided the Division with a compilation of Borough Hall purchases for the period June 1994 through March 1997. This summary listed each invoice number, the total amount of the invoice and a monthly total. The total for each month could be traced to the purchases verified by Borough Hall directly through February 1997, which, after a subsequent correction by the company, totaled \$161,445.00. In addition, at the time of the hearing, petitioner submitted substantially all the invoices from Borough Hall which corresponded with the compilation provided to the auditor. Virtually all of the Borough Hall purchases, primarily cigarettes and candy, were made with cash taken from petitioner's daily sales. Consistent with this information provided at hearing, many of the Borough Hall invoices indicate they were paid for by cash, and the general ledgers submitted at hearing show only one check drawn to Borough Hall in the amount of \$400.00 over the entire audit period. The remaining general ledger entries indicate that cigarette purchases made with cash were included in cost of goods sold for each year. The total of other purchases made by check and the cash cigarette purchases, which comprise the purchases component of the cost of goods sold, can be traced from the general ledger to petitioner's corporate tax returns.

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<sup>1</sup> The amount of purchases originally reported by Borough Hall was \$162,587.00, which formed the basis of the calculation in Finding of Fact "13". Using purchases of \$162,587.00, audited taxable sales per quarter were computed to be \$45,695.00. After consideration of sales as reported by petitioner, the tax assessed totaled \$35,744.06 for the period June 1, 1994 through August 31, 1998. This amount appears as the tax assessed on the notice of determination which is the subject of this matter (*see, Finding of Fact "13"*). The corrected Borough Hall total purchases (\$161,445.00), provided to the Division after issuance of the notice of determination, resulted in a reduction of tax assessed by the Division as set forth in Finding of Fact "11".

9. On May 28, 1998, a consent was executed extending the period of limitation to March 20, 1999, by which time an assessment of sales tax could be made for the original audit period June 1, 1994 through February 28, 1997.

10. On or about September 14, 1998, the Division's Bulk Sales Unit sent a notification to Mr. Levine that SRS News was being sold. As a result, the Division issued an appointment letter which was mailed to petitioner on September 16, 1998, extending the audit period to August 31, 1998, the date the business ceased, requesting journals, ledgers, sales invoices, purchase invoices, cash register tapes, Federal income tax returns and exemption certificates for the updated audit period. The letter set up an appointment with petitioner on September 24, 1998. Petitioner's representative notified the Division that the records could not be ready in such a short time frame, and requested an extension of time to produce the records. The auditor informed petitioner's representative that a 30-day letter would be prepared.

11. In order to compute sales using the Borough Hall purchases, the Division needed a markup or profitability percentage to apply to purchases. Since the Division doubted the reliability of petitioner's records (and likewise its tax return information), the auditor did not use the 36% profitability factor provided by petitioner, but rather computed a mark-up percentage by utilizing Dun & Bradstreet's Cost of Doing Business publication dated July 1987-June 1988,<sup>2</sup> which provides business ratios for 191 lines of business. Under the category Retail Trade, the Division chose to use the business ratios associated with General Merchandise stores, because the Division's auditor deemed this to be the most appropriate category for petitioner's business based on the description of the business provided by the Division's investigator. Using the gross

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<sup>2</sup> Although the auditor's testimony indicated the report covered the period July 1987 through June 1998, the document was clearly marked as covering the period July 1987 through June 1988.

margin percentage and cost of sales percentage from that category, the Division divided the gross margin of 35.28% by cost of sales of 64.72% to arrive at a mark-up on purchases of 54.51%. When the Division multiplied Borough Hall purchases in the amount of \$161,445.00 by the mark-up percentage, and added that amount to the purchases, the Division arrived at a number representing sales from the Borough Hall purchases in the amount of \$249,454.00. Since the Division knew that all of petitioner's products were not purchased from Borough Hall, could not determine what percentage of sales were represented by Borough Hall purchases, and knew that all the Borough Hall purchases and others were paid for by cash, the auditor doubled sales of \$249,454.00 to arrive at total audited sales for the audit period June 1, 1994 through February 28, 1997 in the amount of \$498,908.00, or \$45,355.00 per quarter for 11 quarters. When the audit period was extended to August 31, 1998, the \$45,355.00 was multiplied by 17 quarters, representing the additional six quarters added to the audit period, bringing audited taxable sales to \$771,035.00. Subtracting from total audited sales the sales reported for the audit period in the amount of \$343,554.00, additional taxable sales in the amount of \$427,481.00 resulted, upon which additional tax was computed in the amount of \$35,267.18.

12. Petitioner did not agree with the Division's use of a 54.51% profit ratio since petitioner had provided the Division with a profitability chart several months prior to that time, showing overall profitability of 36%.

13. The Division issued to petitioner, a Notice of Determination dated October 19, 1998, which assessed a total amount due of \$61,856.13 for the period June 1, 1994 through August 31, 1998 (Assessment ID L-015627924-5), consisting of \$35,744.06 in sales tax due, plus penalty and interest of \$13,220.37 and \$12,891.70, respectively. The amount was recalculated, as indicated in Finding of Fact "11," to be \$35,267.18, as a result of the Borough Hall correction

brought to the Division's attention in November 1999, after the Notice of Determination had been issued.

14. On November 16, 1998, petitioner's representative met with the auditor and his group chief for a final conference. No additional records were presented to the Division and Mr. Levine closed the case with the approval of his supervisor.

15. Pertaining to all tax years which encompassed the audit period, 1994 through 1998, at the hearing petitioner introduced its U.S. corporate tax returns (Form 1120S), general ledgers, statements of transaction detail by account, registers which were identified as cash receipts and cash disbursements journals, daily sales records and monthly bank statements from Chemical Bank. Pertinent figures which appeared on the corporate tax returns for the audit period follow:

<b>Tax Year</b>	<b>Gross Receipts or Sales</b>	<b>Purchases</b>
1994	\$101,469.00	\$ 81,641.00
1995	129,991.00	86,885.00
1996	171,672.00	135,657.00
1997	174,405.00	139,618.00
1998	115,970.00	93,349.00

16. The daily sales record consisted of daily lump sum totals listed on a piece of paper. No breakdown of sales was provided. No cash register tapes or other source documents were available to substantiate these amounts. Mrs. Brahmhatt recorded an amount on an empty cigarette carton and submitted the carton flaps to her accountant to create a daily record. After the daily list was created, the carton flaps were discarded.

The bank statements were used to prepare the general ledger and the cash receipts and disbursements journal. The bank statements reflected deposits which were recorded as Sales and



Lotto Collection on petitioner's general ledger. Included in such deposits were two entries made at the close of each year: one to record the Lottery commission earned each year, and a second to record cash received from an unidentified source. The cash received entry is stated to be a deposit, but is not reflected in the deposits section of petitioner's bank statements. No explanation is provided concerning this entry. Subtracted from the total Sales and Lotto Collection amount were payments to Lotto (presumably moneys due to the New York State Lottery), and in years 1995 through 1998, payments of New York State Sales Tax. The resulting amount was found to correspond with gross sales as reported on petitioner's corporate tax returns for tax years 1994 through 1998.

17. During the first day of the hearing in this matter, November 9, 1999, petitioner indicated that it had additional records for the Division's consideration. The Administrative Law Judge requested that the Division review petitioner's records, and permitted the parties to set a mutually agreeable time for doing so upon a later continuance of the hearing. On December 1, 1999, the Division's auditor met with petitioner's representative at his office. The auditor was provided with 1994 and 1995 check disbursements and a list of beverage and soda purchases. The auditor was given seven purchase invoices representing total beverage purchases of all types for the audit period totaling \$705.50. The auditor made a request for cash register tapes, sales invoices, and cash disbursements for the entire audit period, in addition to check disbursements for 1996, 1997 and 1998. None of these records were provided to the Division.

After the meeting, the auditor wrote to the Coca-Cola and Pepsi companies to determine if petitioner had a vendor account with either of them for the purchase of soft drinks. Pepsi did not have an account for petitioner. However, Coca-Cola provided the auditor with a printout of

purchases made by petitioner from January 1996 through August 1998 totaling \$4,541.00. The auditor did not separately use this amount in his calculation of tax assessed.

18. Petitioner's representative conducted an informal survey of similar retail establishments in Manhattan to establish the retail sales price of cigarettes, and presented the results of the survey into evidence. The survey represented the sales price of cigarettes as of June 1, 2000, and indicated that the nine business owners employed an average markup percentage of 17.25% on the cost of cigarette purchases, and realized an average gross profit of 14.65%.

19. On or about August 5, 2000, petitioner submitted to the Administrative Law Judge a list of vendors from whom it purchased various items sold by SRS News. It showed substantial purchases by cash, most of which were for cigarette purchases from Borough Hall. These amounts did not tie into the Borough Hall invoices or the vendor verification of purchases. The list additionally showed an estimate of purchases made for other items subject to sales tax for which no invoices could be located. Part of the vendor purchases which appeared on the list could be traced to entries in the general ledger (which was submitted for review by the Administrative Law Judge during the second day of the hearing), where checks were drawn for such items. Total purchases as set forth on this list for each of the years in issue were as follows: 1994, \$73,896.00; 1995, \$113,787.00; 1996, \$166,095.00; 1997, \$134,559.00; and 1998, \$98,884.00.

### ***SUMMARY OF THE PARTIES' POSITIONS***

20. Petitioner argues that the assessment resulted from actions of the Division that did not provide petitioner with a fair opportunity. Specifically, petitioner maintains that the Division failed to review all of its available books and records, and petitioner takes issue with the Dun & Bradstreet classification of its business as a "general merchandise" store. In addition, petitioner

argues that the audit was not reasonable because the markup was based on a Dun & Bradstreet study for the year 1987-88 which was outdated, and did not correspond to the audit period.

Petitioner does not believe that the investigator's report or any other information acquired by the Division supports the Division's conclusion that the Borough Hall purchases merely constitute 50% of total sales. In fact, petitioner maintains that the Division's auditor failed to conduct an audit, and as a result of this inaction, no additional liability should be imposed, leaving no issue of penalty and interest. Petitioner asserts a flood destroyed some of its business records.

21. Petitioner relied on the testimony of another business owner and the employee of a third business which had similar stores in Manhattan, in an attempt to establish that the markup percentage computed from the Dun & Bradstreet information was excessive. Initially, Mrs. Brahmbhatt could not provide sufficient information about markup percentages when questioned as a witness for petitioner. Later, she estimated profitability on cigarette sales at 16 to 18%, with profitability on all sales at approximately 22%.

22. The Division argues that petitioner failed to produce any sales records and many other pertinent documents to enable an audit to be conducted. Having established the records were insufficient, the Division properly resorted to an indirect method of audit, in this case using the purchase records provided by a supplier and applying a markup from a Dun & Bradstreet study. The Division asserts that its method of audit must be reasonable, but it is not required to utilize the most exact method of audit, and that petitioner's arguments concerning the date of the study are not enough to meet petitioner's burden of showing that the audit was irrational.

On the issue of reasonable cause for abating the penalties, the Division argues that petitioner failed to carry its burden of proof that the audit method was unreasonable or that the determination was erroneous, such that abatement of penalties would be appropriate relief.

### ***CONCLUSIONS OF LAW***

A. Under Tax Law § 1135(a), "[e]very person required to collect tax shall keep records of every sale . . . in such form as the commissioner of taxation and finance may by regulation require." These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Tax Law § 1135[e]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are "sales slip, invoice, receipt, contract, statement or other memorandum of sale, . . . guest check, . . . cash register tape and any other original sales document" (20 NYCRR 533.2[b][1]).

In this case, petitioner did not produce any cash register tapes, sales invoices or any other original sales documentation to verify the amount of sales for the period in question. The Division was not provided with the daily sales records which were submitted for review by the Administrative Law Judge at the hearing. Thus, contrary to petitioner's claim, the Division made a proper determination that petitioner's records were inadequate for purposes of conducting a complete and accurate audit (Tax Law § 1135; 20 NYCRR 533.2).

Furthermore, having reviewed the daily sales records, given the manner in which petitioner recorded such sales and the fact that these daily sheets could not be verified by source documents such as cash register tapes or sales invoices, such records are not accepted to substantiate petitioner's daily sales, nor are they accepted as evidence for the accuracy of petitioner's sales tax returns (*see, Matter of Goldner v. State Tax Commission*, 70 AD2d 978, 418 NYS2d 477, *lv denied* 48 NY2d 608, 423 NYS2d 1025).

B. There is no dispute that the audit methodology utilized in this matter was an indirect methodology not based solely on the books and records of petitioners. In order for the Division

to utilize an indirect methodology, it must show that it made an adequate request for books and records for the entire audit period (*see, Matter of Christ Cella v. State Tax Commn.*, 102 AD2d 352, 477 NYS2d 858), and that it reviewed the records provided in order to determine that the records were inadequate for the purposes of conducting a complete audit (*see, Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978).

The original appointment letter and the subsequent appointment letter which extended the audit period sent by the Division to petitioner constituted an adequate request for books and records and, taken together, cover the entire audit period in issue. This was followed by several other written requests for records, telephone conversations and messages discussing the providing of records and meetings wherein records were requested. The records provided by petitioner during the audit were limited at best, though petitioner continued to claim that records had been ignored by the Division. I believe that many of the records previously requested by Mr. Levine were not forthcoming until the final day of the hearing, after the Administrative Law Judge made it clear that this was petitioner's final opportunity to submit records it claimed had not been reviewed by the auditor. I am convinced that the Division's auditor reviewed all records provided to him. In addition, my review of the corporate tax returns, bank statements, general ledgers, cash receipts and disbursements journals, transactions details, and daily sales records clearly raise significant questions about the reliability of petitioner's methodology of recording its business transactions.

The general ledger was created from the bank statements, with some additional modifications. I am able to trace most items from the general ledger to the corporate returns. The bank deposits, taken from the bank statements, represent product sales and lottery sales. Moneys are paid over to New York State Lottery which is clearly identified on the bank

statement, and petitioner's general ledger shows the "payment" over to Lottery. On the general ledger, the difference between the total sales recorded and lottery payments for 1994 is \$101,469.00, which is the figure recorded as gross sales on Form 1120S, petitioner's corporate tax return for that year. For 1995, 1996, 1997 and 1998 there is an additional subtraction for New York sales tax paid from the net sales amount. Otherwise the computation is the same. If all money collected by petitioner for sales (lottery and product) were deposited, then product sales, exclusive of gross lottery sales, might have represented a valid sales figure for income tax purposes. However, petitioner provided testimony and submitted evidence that substantial cash purchases were made from petitioner's store register, and such funds should have been included as deposits, but it is not clear whether this was done, or to what extent. Mrs. Brahmhatt was responsible for the day-to-day operations of the business. Petitioner's daily sales records consisted of daily lump sum totals listed on a piece of paper which were derived from figures scratched on cigarette carton flaps which Mrs. Brahmhatt gave to her accountant. Allegedly the source of such figures was the result of Mrs. Brahmhatt's counting the money in the register at the end of the day, and adding to that amount any cash disbursed for purchases made by the business. No breakdown of sales, cash register tapes or other source documents was submitted either to Mr. Desai or into evidence at the hearing to substantiate these amounts. After the daily list was created, the carton flaps were discarded. Even if I found Mrs. Brahmhatt's testimony regarding her method of record-keeping credible, which I do not, it is not sufficient to establish the sales of the business.

During Mr. Brahmhatt's testimony, he stated that if petitioner made a payment by cash for inventory items, the invoice was given to petitioner's accountant who recorded it. At the second day of the hearing, petitioner's owner alleged that many of these invoices were lost in a

flood for which a claim was submitted to the Federal government for damages to his property. This fact was never brought to the attention of the Division's auditor. Likewise, no evidence of such flood, corroborating testimony or documents submitted to any agency or insurance company, was submitted in support of this explanation, and thus, this portion of Mr. Brahmbhatt's testimony is deemed not credible.

Each of the general ledgers reflects an entry at year end (with the exception of 1998, when the entry was made on August 31, 1998, at the time the business ceased operations as this petitioner) of a "deposit" which references "cash" and is added to sales of the respective year. This amount does not appear as a deposit on the bank statement, but appears to be more in the nature of an adjusting entry. Although one could argue that some or all of the cash sales were reported when the "adjusting deposit" was made at the end of each year, one could also surmise that an appropriate amount was recorded as an adjustment to make it appear as though the general ledger existed all along and petitioner actually kept good records. The adjustment made the records tie into reported gross sales on petitioner's corporate income tax returns. However, because of the poor methodology petitioner chose to keep track of sales and purchases, and the conflicting testimony which exists, no reasonable assumption can be made that this entry reflects all the missing daily deposits of cash sales, disbursed for petitioner's purchases. It is not possible to accurately trace the actual amount of petitioner's sales or purchases. If the deposits are unreliable to represent sales, and purchases are haphazardly made with cash, invoices carelessly discarded, and amounts estimated without basis (*see*, Finding of Fact "19"), then all documents which result from faulty record-keeping are unreliable, including petitioner's tax returns. It is quite clear in this case that the Division properly disregarded petitioner's records as inadequate and unreliable when assessing whether they were sufficient to conduct a detailed audit.

Therefore, it was acceptable for the Division to calculate petitioners' tax liability based on estimated or indirect audit methods. The records which were not provided to the Division for its review, which now exist in some form, lead me to the very same conclusion.

C. Pursuant to Tax Law § 1132(c)(1), petitioner bears the burden of proving by clear and convincing evidence that the tax assessed was erroneous (*Matter of Rizzo v. Tax Appeals Tribunal*, 210 AD2d 748, 621 NYS 2d 115; *Matter of Mobley v. Tax Appeals Tribunal*, 177 AD2d 797, 799, 576 NYS 2d 412, *appeal dismissed* 79 NY2d 978, 583 NYS2d 195; *Matter of Surface Line Operators Fraternal Line Organization v. Tully*, 85 AD2d 858, 446 NYS2d 451). Furthermore, a presumption of correctness attaches to a notice issued by the Division, and the taxpayer must overcome this presumption (*see, Matter of Suburban Carting Corporation*, Tax Appeals Tribunal, May 7, 1998, citing *Matter of Tivolacci v. State Tax Commn.*, 77 AD2d 759, 431 NYS2d 174; *Matter of Leogrande*, Tax Appeals Tribunal, July 18, 1991, *confirmed* 187 AD2d 768, 589 NYS2d 383, *lv denied* 81 NY2d 704, 595 NYS2d 398).

D. The Division may resort to an estimated or indirect audit method to calculate sales tax due where a taxpayer has failed to present books and records adequate for the Division to conduct a detailed audit (*see, Matter of Urban Liquors v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138). While the method chosen by the Division must be reasonable (*see, Matter of House of Audio of Lynbrook*, Tax Appeals Tribunal, January 2, 1992) and reasonably calculated to reflect the taxes due (*see, Matter of W.T. Grant v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75; *Matter of Ristorante Puglia, Ltd. v. Chu*, 102 AD2d 348, 478 NYS2d 91), the method need not be exact (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, 177, *affd* 44 NY2d 684, 405 NYS2d 454) and the auditor is given



considerable latitude in devising an audit method (*Matter of Grecian Square v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

In the present case the auditor, having no sales records available, utilized purchase records obtained from a supplier. From such information he calculated the total amount of purchases of cigarettes and some candy made by petitioner for the audit period. To this total purchases figure the auditor applied a markup percentage, derived from a Dun & Bradstreet study. Sufficient evidence exists in this record to enable me to determine that the Division has established a rational basis for this audit (*Matter of Grecian Sq. v. New York State Tax Commn.*, *supra*). Therefore, it is incumbent upon petitioners to show by clear and convincing evidence that the audit method was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679, 681).

E. Petitioner maintains that doubling the sales as determined from the Borough Hall purchases is arbitrary and has no basis. The Division points to two reasons for making the assumption that additional sales existed that had not been recorded. The first is by petitioner's own admission that other purchases of petitioner's products were made with the use of cash from petitioner's register. As previously established, it is unclear whether such sales have been accounted for, and it is petitioner's burden to show that such accountability exists.

Secondly, the Division notes the more than fivefold jump in taxable sales as reported on petitioner's sales tax returns (*see*, Finding of Fact "2") commencing with September 1, 1995. Prior to September 1, 1995, petitioner collected sales tax on cigarette sales upon the retail sale, and remitted the tax to the State. Upon the enactment of Tax Law § 1103, effective September 1, 1995, petitioner, as a cigarette agent had to prepay the tax on cigarettes when the cigarettes were purchased from its distributor, and then take a credit on its sales tax returns for the amount of

sales tax previously prepaid. The Division suggests that the dramatic jump in taxable sales is explained as follows: first, cigarette sales were always higher than petitioner reported, and second, total sales were also higher. Since petitioner had to claim a credit for prepaid tax after September 1, 1995, if the credit was higher than sales tax as computed, petitioner would not have been able to claim its credit due. Thus, surmises the Division, petitioner had to increase reported sales tax due to have an amount large enough to offset the credit for prepaid tax. Petitioner's only explanation for the significant rise in taxable sales, is that a business sometimes has a leap in income.

Given the explanation presented by the Division, I will not disturb the auditor's calculation of audited taxable sales, including the amount so doubled, since I believe the decision to increase sales was a rational one based on these facts.

F. Petitioner challenges as faulty the Division's choice of using a Dun & Bradstreet report outside the audit period, and the classification of petitioner's business as a General Merchandise Store. When questioned about the use of a Dun & Bradstreet document which referred to years not within the audit period, the auditor admitted that he used the publication provided to him by his supervisor and did not adjust the Dun & Bradstreet indices for the difference in the time frame (see, Footnote 2) or business conditions. He explained that he attributed his decision not to make any adjustments to the following factors: since Dun & Bradstreet represented averages from all over the country and petitioner was located in Manhattan, it was likely that the markup using only Manhattan indices would have been higher, not lower, than those presented in the Dun and Bradstreet document. In addition, the auditor believed the use of these indices was reasonable, since inflationary factors involving years beyond the report were not taken into

account. Thus, the auditor believed his use of the indices in this case erred on the conservative side.

Concerning the choice of indices used, based upon the category chosen, the auditor believed he employed the category which was best associated with petitioner based upon the description he received of the business from the Division's investigator, and what knowledge he acquired about the business.

The use of the Dun & Bradstreet study to determine the markup is allowable (*see, Shukry v. Tax Appeals Tribunal*, 184 AD2d 874, 585 NYS 2d 531). This is true even though, as pointed out by petitioner, the study was for a time period not within the audit period (*see, Matter of The Humphrey House*, Tax Appeals Tribunal, July 31, 1997) and the study was a national study (*see, Matter of Bitable on Broadway*, Tax Appeals Tribunal, January 23, 1992 *confirmed* 199 AD2d 633, 604 NYS2d 990). The Division introduced the study used into evidence in this matter, allowing petitioner to determine by whom the study was published and the data on which the study was based, thus providing it the opportunity to refute the study with evidence of its own (*see, Matter of Bitable on Broadway, supra; Matter of Fokos Lounge*, Tax Appeals Tribunal, March 7, 1991). Petitioner presented a chart early in the audit to Mr. Levine that showed its overall profitability at 36%. Since petitioner's sales records were essentially nonexistent, and deemed unreliable, a profitability factor derived therefrom is likewise deemed unreliable. Furthermore, Mrs. Brahmbhatt's testimony concerning overall profitability, estimated at 22%, is not at all consistent with her accountant's rendition at 36%, allegedly based on the same set of records. In further support of its position that using a markup of 54% was unreasonable, petitioner presented evidence in the nature of testimony of an owner and employee of other like stores in Manhattan with similar products and, secondly, an informal survey of other like vendors

of cigarettes (in an attempt to establish a competitive markup on cigarettes). The testimony of other shop owners and employees who are not familiar with petitioner's business is not accorded any weight in the determination of what petitioner's markup percentage would have been during the audit period. The survey of cigarette pricing was not connected to the audit period, and did not bear any statistical reliability. Neither the testimony offered nor the survey constitutes clear and convincing evidence that the use of the Dun & Bradstreet study by the Division, and the corresponding higher markup percentage, was irrational (*cf.*, *Matter of Shop Rite Wines & Liquors*, Tax Appeals Tribunal, February 22, 1991). While the Division is required to utilize a reasonable audit method, it is not required to use the most exact audit method (*Matter of Markowitz v. State Tax Commn.*, *supra*). Petitioner has not met its burden of proving that the Division's determination of tax due was incorrect or that the audit method was unreasonable.

G. In addition to the taxes assessed, petitioner was also assessed penalties under Tax Law § 1145(a)(1)(i) and (vi). Tax Law § 1145(a)(1)(i) authorizes a penalty for failure to properly pay any tax imposed under Articles 28 and 29 of the Tax Law. Tax Law § 1145(a)(1)(vi) imposes penalties for failure to report and pay sales tax in an amount in excess of 25% of the amount required to be shown on the return. Tax Law § 1145(a)(1)(iii) and (vi) provide that if the failure or delay was due to reasonable cause and not due to willful neglect, penalties and additional interest shall be abated.

Reasonable cause may be found where destruction of business records is proven (20 NYCRR former 536.5[c][2]). In his testimony, Mr. Brahmhatt stated that SRS's invoices stored in his home basement were destroyed by flooding caused by a rain storm sometime in 1997. Petitioner made no attempt to provide this as an explanation to the auditor at any time until the second day of the hearing, and provided no substantiation that any claim for such destruction was

being asserted. I find Mr. Brahmbhatt's testimony to be less than credible on this point, and thus, petitioner has not established reasonable cause for abatement of penalty based on the destruction of business records pursuant to 20 NYCRR former 536.5(c)(2). Furthermore, the circumstances of this case indicate a lack of good faith, which negates any finding of reasonable cause and the absence of willful neglect (*see*, 20 NYCRR former 536.5[d][1]).

H. The petition of SRS News, Inc., with respect to the Notice of Determination dated October 19, 1998, bearing assessment identification number L-015627924-5, is granted to the extent indicated in Finding of Fact "11"; said petition is in all other respects denied. As modified by Finding of Fact "11", said Notice of Determination is sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE